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This Week in China

China's Growth To Continue Despite Reduction in Lending

China's wide-scale economic recovery can partly be explained by the surge in the country's bank lending this year. In light of recent events, this has left many wondering whether economic growth will suffer now that the government has turned off the credit tap. However, a closer look at the figures reassures us that this may not necessarily be the case.

July's figures show that new bank lending fell to RMB 356 billion (\$52 billion) from RMB 1.53 trillion in June. As last month's headlines flashed "China's bank lending fell by 77%", confidence in the continued recovery of the economy experienced a sharp downturn. But, according to *The Economist*, "...bank lending always slows in the second half of the year; the 12-month pace of growth is therefore a better measure. On a year-on-year basis bank lending grew by an impressive 34% in July, roughly the same pace as in June. Moreover, the

drop in new loans in July largely reflected a fall in short-term bills; medium and long-term loans to firms and households continued to grow briskly."

Additionally, a large chunk of lending to firms earlier in the year is now sitting in deposit accounts. Thus, corporate deposits have soared by 35% over the past year regardless of falling profits. Therefore, even if the government tightens up, this leaves firms with plenty of money to finance investment and sustain recovery.

Tao Wang, an economist at UBS, discounts the concern that an excessive amount of new lending has been used to speculate in asset markets and left banks dangerously exposed. "Some loans certainly found their way into asset markets, but most went into the real economy, mainly for infrastructure investment. Even a small amount going into the stock market, coupled with the expectation of a large amount going in, could have a big impact on prices," Wang said.

"Based on published data, new inflows of money into

the stock market and total imports of metals together amounted to RMB 660 billion in the first half of the year. This is equivalent to less than 10% of total new lending, and only a fraction of that could feasibly have been financed by borrowing," according to *The Economist*.

Thus, it is our view that fears regarding the scale of China's lending have been largely unfounded, leaving us to believe that China's economic recovery will continue its course to 8%+ growth in 2009 and beyond.

In fact the Chinese government think-tank the State Information Center (SIC) predicted recently that after a "normalization" in the growth of bank credit that China's gross domestic product will grow about 8.5% in the third quarter from a year earlier, picking up from the second quarter's 7.9% pace.

Adam Roseman,
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This Week in China (cont'd)

China's Manufacturing Continues Growing

China's manufacturing sector expanded for a sixth straight month in August to a 16-month high, an indication that economic recovery has continued.

Fears that government curbs on bank lending could stall the recovery have led to high volatility in the Shanghai stock market.

Economists said China's recovery was still on track thanks to strong domestic spending and arebound in exports.

The monthly PMI published by the China Federation of Logistics and

Purchasing rose to 54 last month, from 53.3 in July, as domestic demand and strong spending in heavy industries, fueled by Beijing's stimulus measures, spurred growth.

A breakdown of the PMI showed that new orders, output, imports and employment all expanded while exports remained flat.

"It suggests the manufacturing sector is still expanding, mainly because of strong activities in heavy industries such as cars, steel and, increasingly, commodities," said Ben Simpfendorfer, economist at RBS.

The HSBC China PMI,

million SMEs which contribute more than 60% of the nation's GDP, 50% of tax revenues, 70% of import and export trade and 80% of urban employment. But the number of innovation-based SMEs in China is only about 160,000, much less than in the United States.

Wan said to sharpen these enterprises' innovative edge, the ministry planned to make research and development resources more accessible to them.

The ministry would help establish a technology platform participated in by universities, research institutes and enterprises. It would coordinate

published separately, rose to 55.1 from 52.8 in July.

While the strong PMI readings might reinforce concern of overcapacity, economists said any policy tightening in the near term was unlikely.

"Our view is that while Beijing will continue to withdraw some of the stimulus that has done its job (lending and infrastructure spending) and is not longer needed, we will not see any measures designed to slow economic growth. In other words, no 'tightening'", said Andy Rothman, China macro strategist at CLSA.

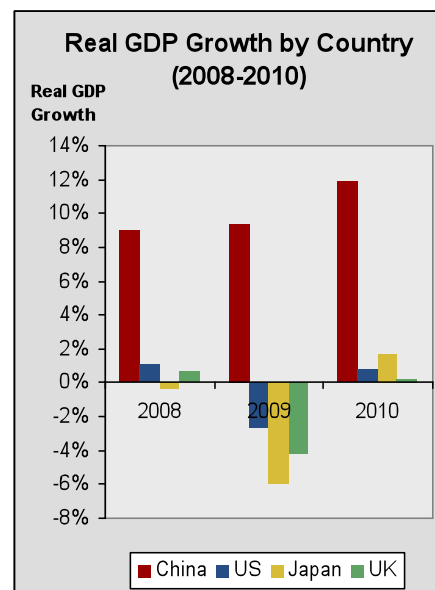
Source: Financial Times

research and development and enable innovation-based SMEs to share the results.

Wan, also vice chairman of the Chinese People's Political Consultative Conference National Committee, said the ministry would set up national State-funded laboratories and technology centers for the SMEs.

To ease technological personnel shortages, the ministry, together with other central departments, would assign 100,000 researchers and technicians from universities and research institutes to the SMEs.

Source: China Daily



Source: Goldman Sachs; Euromonitor

A breakdown of the PMI showed that new orders, output, imports and employment all expanded

China has more than 42 million SMEs which contribute more than 60% of the nation's GDP, 50% of tax revenues, 70% of import and export trade and 80% of urban employment.

Metals and Mining

China Buys Record Iron Ore at Rio's Discount Price

China's steel mills are buying record volumes of iron ore from Rio Tinto at the price China rejected in the acrimonious negotiations which led to the detention of the mining giant's negotiators in July.

The surge in Chinese purchases will lift Rio's total iron ore exports to more than 200,000 tons this year despite the slump in demand during the first quarter.

China is buying aggressively from Rio despite the freeze in diplomatic relations over Chinese allegations of commercial espionage and bribery against four Rio staff.

A Rio spokesman said that the suspension of talks

Beijing Steel Giant Says Annual Output to Reach 30 Million Tons

Shougang Iron and Steel Group expects its annual steel output to reach 30 million tons by 2012, two years after its Beijing facilities are to be shut down.

Shougang was Beijing's biggest polluter before it began cutting output at its Beijing plants for 2008 Olympics. It is now moving production to a 21-square-kilometer, 10 million ton mill in Caofeidian, an islet 220 km east of Beijing, to become the country's largest steel production base.

was not connected to the allegations of commercial espionage but reflected the continuing iron ore sales to China at benchmark prices.

China's official iron and steel trade body, CISA, pushed for a steep discount of 40% off last year's benchmark price of \$92-\$94 per ton but Rio held out for a smaller discount of a third, a price of about \$61 per ton which has been accepted by Japanese and Korean mills.

According to Rio, it is selling every ton at benchmark prices with about half of its output going to China.

Rio Tinto sold 172 million tons during last year's commodity boom when the spot price of iron ore

The new plant will produce 9.7 million tons by the end of 2010 and will further expand production by launching new projects as well as merging and acquiring smaller plants in different provinces.

In its latest expansion plan, Shougang last month acquired 90% of the equities of Changzhi Iron & Steel Co., Ltd., a 3.6 million ton plant in the northern Shanxi Province.

Meanwhile, the Beijing factory site will become a development zone for a wide range of industries including logistic services, real estate development

soared to almost \$200 per ton but mine expansions have increased output potential.

The miner has virtually abandoned the spot market which earlier this year dominated the iron ore trade as buyers abandoned official contracts in favor of spot prices that fell to half the contract rates.

Since then, the spot market has surged higher again, reaching almost \$100 per ton.

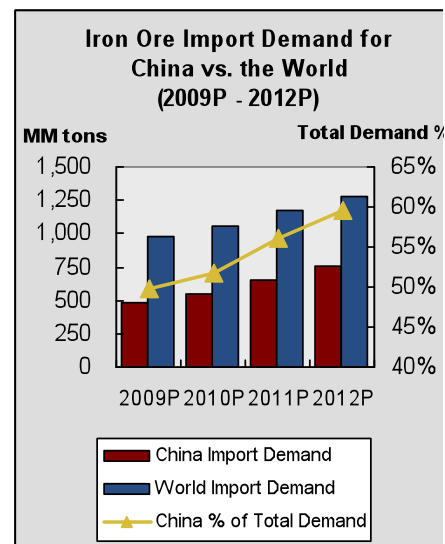
China reached its highest annual steel output in July of 51 million tons, up 12% on the previous year, mainly due to the huge increase in government infrastructure spending. Investment in China's railways is up 150%.

Source: Times

and auto spares production, which will yield an additional RMB 100 billion (\$14.7 billion) a year.

Founded in 1919, Shougang is widely considered the flagship of China's heavy industry. Its Beijing plant produced more than 12 million tons of steel annually before it was forced to cut output and pollution in 2007. Last year, the plant cut output and pollution by 70% to ensure better air quality for the Beijing Olympics.

Source: China Daily



Source: Morgan Stanley

China's steel mills are buying record volumes of iron ore from Rio Tinto at the price China rejected in the acrimonious negotiations which led to the detention of the mining giant's negotiators in July.

Consumer / Retail



Source: Zero2IPO

It is estimated that the Chinese shampoo market is worth RMB 25 billion (\$3.7 billion), with a gross profit rate of between 50% and 70%.

Geely Bids for Money-Losing Volvo

China's Geely Automotive has submitted the only concrete bid so far for Ford Motor-owned carmaker Volvo Car Corp.

The US carmaker put money-losing Volvo cars up for sale in December last year in order to cut costs and raise cash in the face of plunging industry-wide auto sales.

An announcement on which suitor Ford had selected to initiate final takeover negotiations is expected some time next month.

An insider at Geely told China Daily that executives in the company had

signed confidentiality agreements on any potential sale, indicating a deal was on the cards.

"Ford has concluded that the Volvo brand will likely be sold, which is reflected in the company's 'held for sale' accounting status," China Daily was told in an email statement from Ford. "It is premature to discuss pricing, timing or potential bidders."

Jia Xinguang, chief analyst with the Chinese National Automotive Industry Consulting and Development Corp, said: "It's still too early to say that the potential acquisition of Volvo by Geely is beneficial or detrimental, as Geely's chairman Li Shufu

never toes the corporate line. But as Geely is ambitious to enter the premium car segment, acquiring Volvo's brand and assets as well technologies is a shortcut."

"The acquisition not only includes the brand and technology which will positively help Geely on its future development, but also involves Volvo's factory, employees in Sweden and many dealers, parts suppliers even debts overseas," he said. "Geely should think hard whether buying Volvo would be a good thing."

Source: China Daily

China's BYD Says Buffett Wants to Raise Stake

Warren Buffett intends to raise his stake in Chinese electric car and battery maker BYD Co Ltd, sending shares in the company up 8%.

MidAmerican Energy Holdings, a unit of Berkshire Hathaway, bought 10% of BYD for \$230 million or about HK\$8 a share last September, sparking a massive rally in the stock.

"MidAmerican has always intended to raise its stake in BYD because it believes BYD has good prospects in the development of renewable energy, but we are still considering (whether to sell more),"

BYD Chairman Wang Chuanfu told reporters.

China's government has been encouraging local automakers to focus on more fuel efficient models and environmentally friendly technologies.

BYD has ambitious plans for its hybrid and rechargeable electric vehicles, aiming to sell as many as 9 million units by 2025 to take on heavyweights like General Motors and Toyota Motor Corp. It launched a gasoline-electric hybrid electric car, F3DM, in China last year and expects to sell its all-electric car e6 to the United States in 2010, a year earlier than its original 2011 target.

It sold a total of 180,000 vehicles in the first half of the year, up 1.5 times from a year ago, which helped nearly double its net profit to RMB 1.18 billion (\$173 million) for January-June. BYD said it now hopes to exceed its 2009 sales target of 400,000 vehicles.

BYD is keen on a stock market listing in mainland China and may look to do so in the next year.

BYD, which began life as a maker of rechargeable batteries in Shenzhen in 1995, is in talks to sell its batteries to multinational car makers including Volkswagen.

Source: New York Times

Recent Transactions

Chinese Miner Jinchuan Buys 70% Stake in Tiomin Kenya

Chinese mining firm Jinchuan has acquired 70% stake in Tiomin Kenya Limited (TKL) in a bid to revive the titanium mining project located in Kenya's coastal region.

The investment agreement offers Jinchuan a 70% stake in Tiomin Kenya Limited, leaving the Canadian parent with 30%. Jinchuan is expected to

immediately invest \$25 million into the mining project.

The Canadian and Chinese firms hope to mine an average of 330,000 tons of titanium-bearing ilmenite, 77,000 tons of rutile and 37,000 tons of zircon a year from the Kwale Mineral Sands site.

All net cash flow generated by Kwale will be used initially to repay project debt and thereafter net free cash flow will be

distributed pro-rata to Jinchuan and Tiomin.

Jinchuan is China's biggest nickel producer and fourth-largest copper producer. Closing this transaction with Jinchuan will give Tiomin more flexibility to pursue its strategy of leveraging its strong cash position and management team to find and execute an accretive, company-making transaction.

Source: Zero2IPO

PetroChina Invests \$1.7 Billion in Canadian Project

PetroChina has agreed to pay C\$1.9 billion (\$1.7 billion) for 60% stake in two oil sands projects in northern Alberta to help develop the world's second-biggest oil reserves.

The two projects, known as Mackay River and Dover, are being develop-

ed by Athabasca Oil Sands, a privately held Calgary-based group.

"Oil sands projects are very capital-intensive, long-term investments and difficult to fully finance in the traditional equity market," Bill Gallacher, Athabasca's chairman said.

Athabasca owns leases to reserves totaling estimated 10bn barrels, about half of

which are included in the two projects. Production at full capacity is projected to reach 300,000-500,000 barrels a day at a total capital cost of C\$15bn-C\$20bn. The first phase of Mackay River is due to come on stream in 2014 with a daily output of 35,000 b/d at a cost of about C\$1.1bn. Athabasca estimates the two projects are viable at an oil price of US\$50-\$60 a barrel.

Source: Financial Times

FDS China Capital Invests in Sun High for 35.0% Stake

FDS China Capital has reached an investment agreement with Dongguan Sun High (Convenience Store) Co., Ltd., to make a first round investment into the convenience store chain. At the same time, a few famous domestic and overseas VC institutions, PE institutions and Shenzhen Capital Group

Co., Ltd. have expressed the strong interest to follow suit.

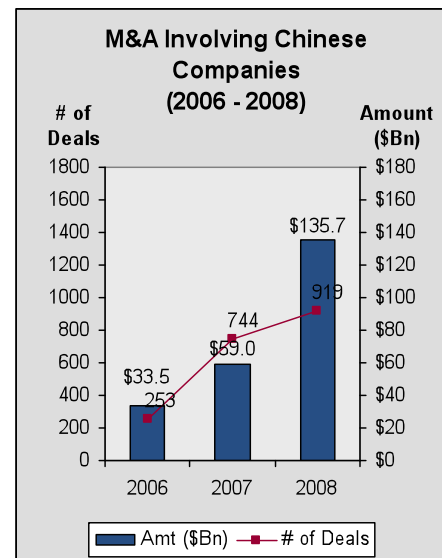
According to the agreement, FDS China Capital will inject the first round of capital into Sun High on August 15, and the second round of capital around October 20th, and in exchange, Sun High will sell some 35.0% of its equity to FDS China Capital.

Sun High, a commercial

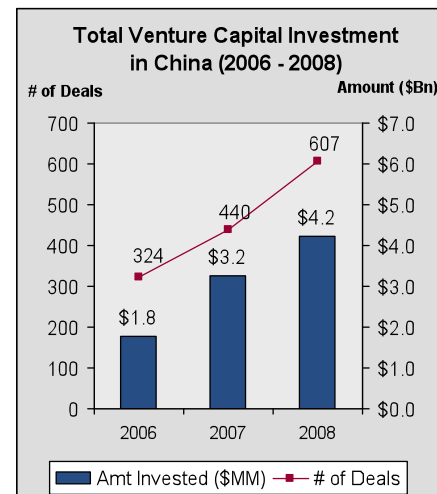
chain founded in 1996, started exploring the convenience store system in 1997. To date, it has opened more than 500 outlets in Dongguan, Zhongshan and Shenzhen in Guangdong Province as well as Enshi City in Hubei Province.

FDS China Capital is a directional investment fund in China that focuses on the chain store sector.

Source: Zero2IPO



Source: Capital IQ



Source: Zero2IPO